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BRIEF

Supreme Court, U.S.
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No. 16-529

IN THE

Supreme Court of the United States

CHARLES R. KOKESH,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Writ Of Certiorari
To The United States Court of Appeals
for the Tenth Circuit

BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

THAYA BROOK KNIGHT
ILYA SHAPIRO
CATO INSTITUTE
1000 Massachusetts Ave., N.W.
Washington, D.C. 20001
tknight@cato.org

MARK A. PERRY
Counsel of Record
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Ave., NW
Washington, D.C. 20036
(202) 955-8500
mperry@gibsondunn.com

GABRIEL K. GILLETT
MARK J. CHERRY
GIBSON, DUNN & CRUTCHER LLP
200 Park Ave.
New York, NY 10166
(212) 351-4000

Counsel for Amicus Curiae

QUESTION PRESENTED

Under 28 U.S.C. § 2462, any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued."

The question presented is:

Does the five-year statute of limitations in 28 U.S.C. § 2462 apply to claims for "disgorgement"?

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute is a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies was established in 1998 to help restore the principles of limited constitutional government that are the foundation of liberty. Cato's Center for Monetary and Financial Alternatives was established in 2014 to reveal the shortcomings of today's monetary and financial-regulatory systems and to identify and promote alternatives more conducive to a stable, flourishing, and free society. Toward those ends, Cato publishes books and studies, conducts conferences and forums, produces the annual Cato Supreme Court Review, and files amicus briefs.

Cato regularly advocates for free markets and limited government. This case arises at the intersection of both issues. It concerns Cato because it implicates core questions about limits on the authority of federal agencies to bring enforcement actions involving conduct that occurred many years in the past and that, at the time, may have been widely accepted. This Court's decision will have wide ranging and dramatic impacts on the securities industry and, potentially, on other industries subject to the ever-expanding federal regulatory state. Just as Cato submitted amicus briefs to this Court in a number of securities-law cases, including *Gabelli v. SEC*, No. 11-1274 (2012), and *Salman v. United States*, No. 15-628 (2016), it submits this brief to emphasize that allowing the SEC

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[1] All parties have consented to the filing of this brief. *Amicus* states that this brief was not authored in whole or in part by counsel for any party, and that no person or entity other than *amicus*, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

to pursue stale claims would be bad public policy and would redound to the detriment of the citizenry.

INTRODUCTION AND SUMMARY OF ARGUMENT

Just four years ago, this Court unanimously held that the SEC must bring enforcement actions seeking civil money penalties within the five-year limitations period of 28 U.S.C. § 2462. *Gabelli v. SEC*, 133 S. Ct. 1216 (2013). Among other rulings in *Gabelli*, this Court specifically found no valid justification for the SEC to pursue claims more than five years after the relevant conduct had occurred. *Id.* at 1221-23. And this Court extolled the virtues of setting "a fixed date when exposure to the specified Government enforcement efforts ends." *Ibid.*

Rather than accept the holding and principles of *Gabelli*, the SEC has consistently attempted to circumvent and subvert this Court's decision. In case after case, the SEC continued to bring enforcement actions involving stale conduct, arguing that the relief being sought—monetary disgorgement, injunctions requiring defendants to obey the law, and declaratory judgments that laws were violated—was "equitable" and thus not subject to the statutory limitations period. The SEC did so knowing full well that it could not seek civil money penalties based on that same conduct. And the SEC knew full well that this Court had already rejected the core of its argument (albeit in a different but materially indistinguishable context) that Section 2462 does not apply to its enforcement actions.

The SEC is as wrong today as it was four years ago. As petitioner ably explains, the SEC's requests for disgorgement fall squarely within Section 2462.

Disgorgement is the modern incarnation of common-law forfeiture, and disgorgement is punitive because, in the SEC enforcement context, it serves no remedial purpose. *See* Pet. Br. 12-18, 23-37. Section 2462 likewise should apply to the SEC's requests for injunctive or declaratory relief. Those remedies may have been conceived as equitable and remedial, but as used by the SEC today they are anything but. They do not restore victims to their *status quo ante*. They do not aid public securities-law enforcement or encourage private compliance. *See SEC v. Graham*, 823 F.3d 1357, 1362 (11th Cir. 2016). And they are the equivalent of the professional death penalty for securities market participants. As the Fifth Circuit explained:

> The SEC's sought-after remedies would have a stigmatizing effect and long-lasting repercussions. Neither remedy addresses past harm allegedly caused by the Defendants. Nor does either remedy address the prevention of future harm in light of the minimal likelihood of similar conduct in the future. ... [T]he SEC is essentially seeking a lifetime ban against the Defendants. Courts have held that such long term bans can be construed as punitive.

SEC v. Bartek, 484 F. App'x 949, 957 (5th Cir. 2012) (per curiam), *dismissing petition for cert.*, 133 S. Ct. 1658 (2013) (granting SEC's motion to withdraw petition for certiorari shortly after this Court decided *Gabelli*).

To put an end to the SEC's gamesmanship, this Court should now categorically hold that the SEC may not institute an enforcement action seeking disgorgement, injunctive or declaratory relief more than five years after the conduct occurred. In the context of the

SEC enforcement scheme, such relief operates as a "civil fine, penalty, or forfeiture, pecuniary or otherwise." 28 U.S.C. § 2462. While the plain text of Section 2462 is sufficient to resolve the case, Cato wishes to emphasize that enforcing the statutory time-bar is good public policy for two primary reasons.

First, allowing the government unlimited time to pursue an enforcement action is against the public interest. The SEC is an administrative juggernaut with a sufficiently large budget to allow it to pursue meritorious claims well within the five-year period. And allowing the SEC to pursue stale claims would actually weaken the enforcement of the securities laws. It would tempt the agency to pursue conduct that ended long ago, distract the agency from its stated priorities of pursuing current malfeasance, and mislead Congress and the public into believing that modern markets are rife with misconduct.

Second, allowing the government unlimited time to pursue claims would be detrimental to the many individuals and businesses who are potential targets of SEC enforcement actions. It would cast an omnipresent pall of potential liability over issuers, underwriters, broker-dealers, directors, officers, shareholders, investment advisers, bankers, attorneys, accountants, and others involved in the financial markets—robbing them of repose and certainty, and forcing them to perpetually prepare for the possibility of liability, no matter how long ago the conduct ended. It would also heighten concerns that the SEC will one day change its mind—as it has multiple times before—and find conduct that was once widely viewed as acceptable to be improper.

ARGUMENT

I. GRANTING THE GOVERNMENT UNLIMITED TIME TO PURSUE CLAIMS IS CONTRARY TO THE PUBLIC INTEREST

Permitting the SEC to bring enforcement actions based on conduct that ended more than five years earlier would not serve the public good. In fact, it would do the opposite. The SEC's core mission—to maintain fair, orderly and efficient markets; protect investors; and facilitate capital formation—is not advanced by enforcement actions based on conduct that occurred more than five years earlier. Those actions neither deter current misconduct nor restore victims to their pre-misconduct state. Rather, the ability to bring such actions based on stale conduct tempts the agency to dedicate its resources to pursuing stale claims and fighting yesterday's battles, diverting resources away from policing the rapidly evolving securities markets and responding to current challenges.

A. The SEC Has Vast Resources That Allow It To Bring Meritorious Actions Within Five Years.

There is no doubt that the SEC is fully equipped to pursue any viable enforcement actions well within Section 2462's five-year limitations period. The SEC "has emerged in recent years as an expansive and powerful enforcement apparatus." William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 149-63 (2011). In fiscal year 2016, the SEC budgeted nearly $515 million for enforcement, which included over 1,450 full-time employees in that function—nearly 20 percent more employees than in any other function.

SEC, *FY 2017 Congressional Budget Justification* 14, 16 (2016), available at https://www.sec.gov/about/reports/secfy17congbudgjust.pdf ("*SEC Cong. Just.*"). The SEC used those resources to bring more enforcement actions (807), and to secure more awards for monetary sanctions ($4.2 billion), than ever before. *Id.* at 58. And the SEC was wildly successful, obtaining relief on one or more claims in a startling 92% of its cases. *Id.* at 37. Not content, the SEC has requested an additional $30 million and 52 additional employees for enforcement for fiscal year 2017. *Id.* at 14, 16.[2]

On top of these resources, the SEC's six-year-old whistleblower program is now "among the most powerful weapons" in its "law enforcement arsenal," offering substantial bounties and other rewards to insiders who report securities-law violations. SEC, Welcome to the Office of the Whistleblower, http://www.sec.gov/whistleblower (last visited Mar. 2, 2017). In fiscal year 2015 alone, the SEC received approximately 4,000 whistleblower tips, up about 10 percent from the prior year, and more tips than ever before. *SEC Cong. Just.* 59. As of January 2017, the SEC had doled out more than $142 million to whistleblowers—with eight of the ten largest awards coming in the past year—

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[2] The SEC's success is in no small part attributable to its increasing preference for bringing enforcement actions before its captive tribunal rather than in district court—projecting 665 new administrative actions in fiscal year 2017, as compared to 170 new actions in federal court. *SEC Cong. Just.* 62; *see also* Jean Eagleshan, *The SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015) (finding SEC won 90 percent of cases before ALJs but only 69 percent of cases in court). The constitutionality of the SEC's Administrative Law Judges is the subject of ongoing litigation in the courts of appeals. *Compare Bandimere v. SEC*, 844 F.3d 1168, 1181-82 (10th Cir. 2016), *with Raymond J. Lucia Cos., Inc. v. SEC*, 832 F.3d 277, 289 (D.C. Cir. 2016), *judgment vacated, reh'g en banc granted* (Feb. 16, 2017).

and recovered "more than $935 million in financial remedies" as a result of whistleblower tips. SEC, Whistleblower Awards, https://www.sec.gov/page/whistleblower-100million (last visited Mar. 2, 2017). The SEC Chair touted the whistleblower program as "enormously successful ... a game-changer in many ways. [I]t's something that has really enhanced the enforcement program tremendously."[3]

To be sure, many SEC enforcement actions "are complex and can take extended periods of time to develop successfully." *SEC Cong. Just.* 38. But the SEC itself recognizes that "[t]imeliness in filing actions is important because it can enhance the action's deterrent impact." *Ibid.* That may explain why, since 2011, the SEC has on average taken fewer than 22 months to go from opening an investigation to commencing an enforcement action, and filed 62 percent of its enforcement actions within two years of opening an investigation. *Ibid.*

Requiring the SEC to bring its claims within five years—nearly three times longer than the average time it takes to bring claims—is therefore more than sufficient. Five years is as long as or longer than the statute of repose for every cause of action under either the Securities Act of 1933 or the Securities Exchange Act of 1934. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359-62 (1991). Five years is also as long as or longer than the amount of time that victims of securities fraud have to file private enforcement actions under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, *Merck*

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[3] *Financial Services and General Government Appropriations for Fiscal Year 2017: Hr'g before the Subcomm. on Fin. Servs. and Gen. Gov't of the S. Comm. on Appropriations*, 114th Cong., 2d Sess. 39 (2016) (statement of Mary Jo White, Chair, SEC) (hereinafter "*FY 2017 Appropriations Hr'g.*").

& Co. v. Reynolds, 559 U.S. 633, 637-38 (2010) (citing 28 U.S.C. § 1658(b)), even though private plaintiffs are "a far cry from" the SEC and are not "armed with [its] weapons," *Gabelli*, 133 S. Ct. at 1221-22.

There is no valid reason why the SEC should need more than five years before waiting to bring an action. The agency is fully equipped and well-versed in bringing claims within five years, regardless of the relief it seeks to recover. And the agency may commence a civil action at any time and take discovery under the Federal Rules of Civil Procedure to obtain evidence needed to prove its claims. *See, e.g.*, *SEC v. One or More Unknown Traders*, 825 F. Supp. 2d 26, 30 (D.D.C. 2010) (granting SEC motion for expedited discovery and a preliminary injunction).[4]

Certainty, uniformity, regularity, and the orderly administration of justice would be furthered by requiring the SEC to comply with the statutory time-bar no matter whether it seeks civil money penalties, disgorgement, an injunction, or a declaratory judgment. The SEC gains nothing by being able to pursue claims based on conduct that occurred more than five years in the past. The markets and the public, by contrast, have much to lose.

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[4] In the unusual case, the SEC may ask the subject of an investigation to consent to toll the statute of limitations, "to allow time for sharing of information in furtherance of reaching a settlement." SEC Div. of Enforcement, Enforcement Manual 32 (2016). Nonetheless, SEC staff are directed to "take care not to delay or slow the pace of an investigation based on the potential availability or existence of a tolling agreement. Swift investigations generally are most effective and enhance the public interest." *Id.* at 41.

B. Giving The SEC Carte Blanche To Pursue Old Cases Would Weaken Enforcement Of The Securities Laws.

Permitting the SEC to bring claims based on conduct that occurred more than five years earlier would actually undermine the agency's mission to enforce the securities laws. As this Court has noted, just because a construction of a statute "[e]xtend[s]" the reach of the securities laws, "it does not follow that the objectives of the statute are better served." *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188 (1994).

This case provides a compelling illustration of that principle. Granting the SEC unlimited time to pursue old and stale cases invites distraction from the agency's core mission "to bring timely, high-quality enforcement actions" and "to protect investors." *SEC Cong. Just.* 5-6; *see also* Arthur B. Laby & W. Hardy Callcott, *Patterns of SEC Enforcement Under the 1990 Remedies Act: Civil Monetary Penalties*, 58 ALB. L. REV. 5, 51-52 (1994). By contrast, having a firm and uniform end date for when conduct can no longer be subject to an enforcement action—whether seeking a civil fine or so-called equitable relief—encourages the SEC to focus its resources on pursuing fresh cases that, if urgently investigated, might protect market participants and prevent investor losses.

The SEC's (mis)interpretation of Section 2462 has lured the agency away from pursuing fresh cases involving current issues and potential problems, and enticed it into pursuing out-of-date actions based on conduct that primarily occurred more than five years in the past. In this case, for example, the SEC brought claims against petitioner in 2009, based on conduct that occurred as far back as 1995. Pet. Br. 5. As relief,

the SEC sought disgorgement of $34.9 million, plus more than $18 million in prejudgment interest. *Id.* at 6-7. But the SEC conceded that a staggering $29.9 million of the $34.9 million it sought to disgorge (and more than $15 million in corresponding interest) came from conduct that occurred more than five years before it filed suit. *Ibid.*

It is beyond reasonable "to expect the SEC to focus its efforts on bringing claims in a timely fashion against those who are guilty of serious and intentional misconduct." Steven R. Glaser, *Statutes of Limitations for Equitable and Remedial Relief in SEC Enforcement Actions*, 4 HARV. BUS. L. REV. 129, 155 (2014). "The very fact that the SEC has waited so long" to bring cases like this suggests that "imposing sanctions on the defendant is not a top priority." *Id.* at 147. The SEC's unexplained delay in pressing its claims also "call[s] into question whether the defendant actually poses a threat to society" and whether an enforcement action is worth pursuing at all. *Ibid.*

Add to this that pursuing disgorgement years after-the-fact does not actually enhance securities-law enforcement or remedy past misconduct. The SEC's "so-called disgorgement does not purport to order specific performance, a constructive trust, or an equitable lien over specific funds or property derived from the alleged wrongdoing." Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 1, 7-8 (2013), http://www.hblr.org/2013/11/the-equity-façade-of-sec-disgorgement. That is because the "primary purpose of disgorgement is not to compensate investors." *SEC v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 102 (2d Cir. 1978). The recovered funds instead go into the vaults of the U.S. Treasury, not the pockets of the victims. In fact, SEC rules

may bar the agency from using funds disgorged based on conduct more than five years earlier from being used to compensate victims through a Fair Fund. *See* 17 C.F.R. §§ 201.1100, 201.1102(b) (2016). Hence, there is no reason to grant the SEC unlimited time to pursue disgorgement in these musty cases—which are "inherently suspect" and likely "marginal" because of their age. Glaser, *supra*, at 148, 154-155 (noting that the "public does not benefit from a framework in which the SEC can wait as long as it pleases to impose significant sanctions"); *see also* Fred D'Amato, *Comment: Equitable Claims to Disgorged Insider Trading Profits*, 1989 WIS. L. REV. 1433, 1438 (1989) (concluding that disgorgement in insider-trading cases "failed to strengthen the deterrence, detection or punishment of inside traders").

Seeking punitive injunctive relief and declaratory judgment based on old conduct, like pursuing disgorgement based on old conduct, similarly does not aid SEC enforcement. When the SEC secures an "obey-the-law" injunction prohibiting conduct that has already ceased, or secures a declaratory judgment stating that securities laws were violated by conduct long ago, it is not remedying past misconduct or protecting investors. *See, e.g.*, *Graham*, 823 F.3d at 1362 ("The SEC urges us to exempt declaratory relief from § 2462 because the SEC may use findings of past violations of securities laws to obtain other remedies. We are unpersuaded."); *Johnson v. SEC*, 87 F.3d 484, 490 n.9 (D.C. Cir. 1996) ("If the SEC really viewed Johnson as a clear and present danger to the public, it is inexplicable why it waited *more than five years* to begin the proceedings to suspend her"). Punitive injunctions and declaratory judgments should therefore be subject to Section 2462's five-year limitations period, just like civil money penalties and disgorgement.

If the SEC's conception of its injunctive and declaratory relief powers result in judicially enforceable orders, *see SEC v. Goble*, 682 F.3d 934, 948-50 (11th Cir. 2012) (citing Fed. R. Civ. P. 65(d)), they operate like brutal late hits after the defendant is already down. Those measures are widely acknowledged as "severe" penalties that can have ruinous collateral consequences for a securities market participant. 6 Thomas Lee Hazen, Treatise on the Law of Securities Regulation § 16.2[2][A] (2015); *see also Bartek*, 484 F. App'x at 957 (warning about a "stigmatizing effect" and "long-lasting repercussions" from SEC injunctions and declarations). SEC Commissioners have recognized that the upshot of these supposedly equitable remedies—which the agency contends may be imposed based on old conduct—"may be more devastating than a monetary fine" that the SEC indisputably *cannot* levy based on old conduct. Luis A. Aguilar, Comm'r, SEC, Speech at Securities Enforcement Forum 2012: Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws (Oct. 18, 2012), available at http://www.sec.gov/News/Speech/Detail/Speech/1365171491510.

Over time, allowing the SEC to pursue stale claims will further tempt the agency to chase outsized disgorgement awards. Because the SEC may broadly seek disgorgement of a "reasonable *approximation*" of the amount of ill-gotten gains—not a precise measure of a defendant's receipts—it has the ability to dramatically and arbitrarily inflate the amount it seeks. Indeed, reported decisions indicate that the SEC has stretched the concept of "disgorgement" far beyond its equitable roots, to reach:

- Profits earned by a defendant directly, *SEC v. Wolfson*, 249 F. App'x 701 (10th Cir. 2007);

- Profits earned and held by a co-conspirator, *SEC v. Calvo*, 378 F.3d 1211, 1215-16 (11th Cir. 2004) (per curiam);
- Reductions in a defendant's losses, *SEC v. JT Wallenbrock & Assoc.*, 440 F.3d 1109, 1117 (9th Cir. 2006);
- Legitimate operating expenses (e.g., paying employees and vendors) paid to innocent third parties, *SEC v. Brown*, 658 F.3d 858, 861 (8th Cir. 2011);
- Funds earned for and held by a defendant's employer, *SEC v. Contorinis*, 743 F.3d 296, 309-10 (2d Cir. 2014);
- Gains, such as stock appreciation, caused by events unrelated to the defendant's conduct, *SEC v. Teo*, 746 F.3d 90, 100-09 (3d Cir. 2014);
- Household expenses incurred by a defendant's spouse, *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1089 (D.N.J. 1996), *aff'd* 124 F.3d 449 (3d Cir. 1997);
- Funds already repaid to victims, *Johnson*, 87 F.3d at 492 & n.13; and
- Prejudgment interest that may dwarf the actual disgorgement amount, *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1476 (2d Cir. 1996).

In the past, the SEC exercised discretion by declining to seek futile disgorgement awards that could not be satisfied. *See* 17 C.F.R. § 201.630. In recent years, however, the SEC has aggressively pushed for disgorgement of extreme amounts based on long-cold conduct. *See, e.g., In re Larry C. Grossman*, 2016 WL 5571616 (SEC Sept. 30, 2016) (ordering disgorgement

of nearly $4 million plus prejudgment interest, and industry and officer-director bars, based solely on alleged misstatements made eight years earlier); *SEC v. Wyly*, 950 F. Supp. 2d 547, 550 (S.D.N.Y. 2013) (seeking disgorgement of roughly $550 million in stock gains, plus prejudgment interest, based on allegations stretching back eighteen years), *appeal pending* No. 15-2821 (2d Cir.); *accord Courts May Be Losing Patience with the SEC's Insistence on Unjustified Bar Orders and Other Draconian Remedies*, Securities Diary Blog, https://securitiesdiary.com/2014/08/20/courts-may-be-losing-patience-with-the-secs-insistence-on-unjustified-bar-orders-and-other-draconian-remedies/ (Aug. 20, 2014) (describing and lamenting SEC's trend of seeking "ruinous" and "debilitating" relief "that go far beyond reasonable remedial responses to the violations alleged").

What's more, the SEC then uses the inflated disgorgement awards based on *old* conduct to try to justify additional resources to police *current* conduct. The SEC's most recent justification submission is telling. In asking Congress for more funding and staff, the SEC argues that it is "vital" to its "mission to bring timely, high quality enforcement actions" and to "promptly detect[] and deter[] violations of the Federal securities laws." *SEC Cong. Just.* 6, 8. The SEC also highlights a purported need to "continue to expand its enforcement function to keep pace with the growing size and complexity of the nation's markets and to swiftly and aggressively address misconduct." *Id.* at 6. As the SEC notes, in the past year it brought a "record number of enforcement actions" and obtained orders "for monetary remedies exceeding $4 billion." *Ibid.*

But the SEC fails to disclose that many of those enforcement actions and monetary awards are based on conduct that occurred more than five years in the past, *not current misconduct*. Over 136 pages discussing years of SEC activity, the SEC never notes that it has been obtaining disgorgement awards based on stale conduct that cannot be the basis for civil penalties. The SEC's refusal to distinguish between judgments based on past and current conduct has understandably created confusion among Members of Congress. *See, e.g.*, *FY 2017 Appropriations Hr'g.* (statement of Sen. Coons) (questioning whether the SEC's "enforcement caseload volume [is] a signal that there is more illicit activity going on," or just that the agency is bringing more actions). And it may be misleading Congress into approving additional funding and staff supposedly to "keep pace with [the] constantly evolving" securities markets (*SEC Cong. Just.* 6-7, 59), when at least some of those resources are actually being used to police conduct that ended more than five years earlier.

At bottom, applying Section 2462's five-year limitations period to all SEC claims is in the agency's best interest as well as the public's and the judiciary's. *Accord* Glaser, *supra* at 155 ("The public does not benefit from a framework in which the SEC can wait as long as it pleases to impose significant sanctions"). The SEC will no longer be forced "to choose between the competing priorities of collecting disgorgement and taking direct action to stop ongoing fraud." U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-02-771, SEC ENFORCEMENT: MORE ACTIONS NEEDED TO IMPROVE OVERSIGHT OF DISGORGEMENT COLLECTIONS 17 (2002). Instead, as SEC officials and staff have noted, the agency can "best serve[]" investors by being able to "concentrate more of its resources on stopping ongoing

fraud than on collecting disgorgement, because stopping ongoing fraud keeps investors from losing more money." *Id.* at 13. In other words, if the SEC is prohibited from bringing enforcement actions based on decades-old conduct, it can focus on prosecuting and preventing whatever misconduct might exists *today*. That will honor the SEC's mission "to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation." *SEC Cong. Just.* 8.

II. ALLOWING THE GOVERNMENT TO PURSUE CLAIMS MORE THAN FIVE YEARS OLD IS BAD FOR MARKET PARTICIPANTS AND THE ECONOMY

The very logic that drove this Court's unanimous decision in *Gabelli* applies with equal force here, to SEC claims for nominally equitable relief. Allowing the SEC to seek disgorgement, or injunctive or declaratory relief, based on conduct that occurred more than five years in the past would create deep uncertainty in the market. It would harm businesses, investors, individuals, and entities by forcing them to perpetually bear the burden of potential liability.

A. Permitting The Pursuit Of Old Claims Creates Perpetual Liability And Uncertainty.

Allowing the SEC to pursue what it deems to be equitable relief based on conduct more than five years old would create a cloud of potential liability over every participant in the financial markets, and an ever-present fear that decades-old conduct could give rise to an enforcement action at any moment. This uncertainty would restrict the decision-making of hundreds of securities firms, banks and asset managers that provide capital for businesses, promote job

creation, and lead economic growth in communities across the country.

Market participants need certainty about when they are clear of potential liability. As this Court explained in *Gabelli*, statutes of limitations are important precisely because they set "a fixed date when exposure to the specified Government enforcement efforts ends, advancing the basic policies of all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities." 133 S. Ct. at 1221 (internal quotation marks omitted). Established limitations periods, the Court explained, further "promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared. They provide security and stability to human affairs [and are] vital to the welfare of society." *Ibid.* (internal quotation marks and citations omitted).

The *Gabelli* Court recognized that "even wrongdoers are entitled to assume that their sins may be forgotten." 133 S. Ct. at 1221 (internal quotations omitted). And the Court reminded that a wrongdoer's sins are easier to forget when the government acts as the sovereign seeking remediation or retribution on behalf of the public, rather than the "victim seeking recompense" directly. *Id.* at 1221-22 ("the SEC as enforcer is a far cry from the defrauded victim").

The same principles animating the Court's decision in *Gabelli* apply with equal force here. The SEC's attempts to litigate the propriety of long-completed conduct deprives participants of the tangible benefits of certainty even when the relief is denominated as

"equitable." Moreover, the important policies that *Gabelli* highlighted—repose, efficiency, predictability, and fairness—are equally important whether the SEC seeks a civil fine, disgorgement-as-forfeiture, or other punitive measures. *See Wilson v. Garcia*, 471 U.S. 261, 266 (1985) ("Few areas of the law stand in greater need of firmly defined, easily applied rules than does the subject of periods of limitations"); *Dirks v. SEC*, 463 U.S. 646, 664 & n.24 (1963) ("[I]t is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by" the SEC). *Cf. 3M Co. v. Browner*, 17 F.3d 1453, 1457 (D.C. Cir. 1994) ("Given the reasons why we have statutes of limitations, there is no discernible rationale" for limiting Section 2462 to judicial proceedings).

Indeed, freeing the SEC of any limitations period for initiating enforcement actions would make repose impossible because it would "leave defendants exposed to Government enforcement action not only for five years after their misdeeds, but for an additional uncertain period into the future." *Gabelli*, 133 S. Ct. at 1223 (noting rejection of a rule that would have frustrated repose by "extend[ing] the limitations period to many decades" (internal quotation marks omitted)). As Chief Justice Marshall poignantly explained, giving the government such unfettered authority to bring actions "at any distance of time" would be "utterly repugnant to the genius of our laws. ... In a country where not even treason can be prosecuted after a lapse of three years, it could scarcely be supposed that an individual would remain forever liable" for civil securities-law infractions. *Adams v. Woods*, 6 U.S. (2 Cranch) 336, 342 (1805).

Repose also provides concrete benefits to the efficient functioning of our capital markets. Under the SEC's interpretation of Section 2462, individuals and companies who reasonably believe that their conduct is lawful—and the entirely innocent persons and entities that transact with them—would never be free from SEC claims, no matter how far in the past that conduct occurred. They are unlikely to take any solace in being free from liability for civil money penalties for claims accruing five years earlier if, at any point in the future, they may nonetheless be forced to disgorge funds they never held, to suffer the consequences of being branded a securities-law violator, or to give up their chosen occupation in the securities industry. This will impede capital formation and fluidity as market participants are forced to reserve (or insure) against ever more remote enforcement contingencies.

This uncertainty will have direct economic impacts. It will raise the cost of business transactions, making due diligence more difficult and burdening successor corporations with latent liabilities they could not have known to protect against. It will also artificially reduce the risk-taking that is inherent and necessary for capitalism to function. It is not hard to imagine overly cautious lawyers squashing a great many innovative ideas out of concern about potential future enforcement actions many years down the road. This could lead many companies and individuals with valid but untested financial products to opt out of the market, preferring to withhold funding and investment opportunities rather than face perpetually overhanging liability. It could also lead talented individuals to select a career outside of securities, knowing they could one day lose their ability to earn a paycheck.

The negative impacts of the uncertainty resulting from the SEC's interpretation of Section 2462 will be felt far beyond the securities industry. Congress designed Section 2462 to serve as a catch-all statute of limitations for civil enforcement actions that applies "throughout the U.S. Code." *Gabelli*, 133 S. Ct. at 1219. If claims instituted by the SEC's Enforcement Division for self-styled equitable relief were exempt from Section 2462, then myriad federal agencies might claim free rein to bring decades-old actions against individuals and entities subject to their ever-growing reach. *See, e.g.*, Clyde Wayne Crews, Jr., *Ten Thousand Commandments 2016: An Annual Snapshot of the Federal Regulatory State* 6, Competitive Enter. Inst. (2016) (estimating that over ten years the number of "economically significant" rules in the regulatory pipeline increased by 54.6 percent and the aggregate enforcement budget of federal agencies increased by 28 percent, to $63 billion). Congress's purposeful decision to enact a default rule providing a five-year limitations period for civil enforcement actions essentially would be nullified.

If the risk of perpetual potential liability actually materializes as a case premised on old conduct, the allegations will be especially difficult for a defendant to contest. When claims are "allowed to slumber" for more than five years, often "evidence has been lost, memories have faded, and witnesses have disappeared." *Order of R.R. Telegraphers v. Ry. Express Agency*, 321 U.S. 342, 349 (1944); *see also United States v. Kubrick*, 444 U.S. 111, 117 (1979). For that reason, in those untimely cases it is harder, if not impossible, to reach "just determinations of fact." *Wilson*, 471 U.S. at 271; *see also* Laby & Callcott, *supra*, at 52 (the "faded memories and the disappearance of

evidence may make it harder for the SEC to prove violations (and harder for some innocent defendants to demonstrate their blamelessness)"). That in turn increases the length and cost of litigation, as the parties are forced to pursue leads that are less likely to yield admissible evidence. It also multiplies the inherent uncertainty of litigation by making it harder to evaluate the strength of each side's trial position.

This puts market participants on the horns of a dilemma. Should they squander even more capital on recordkeeping by permanently preserving millions of pages of documents and terabytes of data to potentially defend against an unknown future claim? *See, e.g.*, Deloitte Transactions and Business Analytics LLP, *5 Questions About Books And Records Compliance* (2017) ("A large broker-dealer may be required to produce and properly store several hundred different types of records" many of which "are assembled from data stored in multiple information systems, external sources and markets"). Or should they risk being unable to prove a valid defense years after-the-fact because the critical documents have been lawfully purged? *See, e.g.*, 17 C.F.R. § 240.17a-4 (requiring exchange members and broker/dealers to preserve certain records for up to six years); 17 C.F.R. § 275.204-2 (requiring investment advisors to maintain various records for five years). Meanwhile, the SEC may not face such an untenable choice: it can retain the relevant documents it acquires during an investigation until it is ready to bring charges (or, perhaps, until after the target has purged its files).

The risk of liability stretching far into the past may have the additional effect of immunizing the SEC from being challenged. Defendants may well opt to

settle even questionable SEC claims rather than expending significant legal fees and risking astronomical disgorgement judgments requiring repayment of funds disbursed long-ago, if ever held at all. *Cf.* Br. for Mark Cuban as *Amicus Curiae* Supporting Pet. at 1, 3, *Salman v. United States*, No. 15-628 (May 13, 2016) (highlighting personal, professional, and financial costs of challenging and beating baseless SEC allegations rather than admitting that acceptable conduct was improper). And the SEC, secure in knowing that it may never be forced to prevail on its aggressive legal theories or prove its factual allegations at trial, may well become emboldened and pursue evermore far-fetched claims. That would be bad for everyone.

B. The SEC's Practice Of Engaging In Revisionist History Exacerbates The Danger Of Allowing It To Pursue Stale Claims.

The SEC's evolving policy positions and enforcement initiatives magnify the unfairness of never-ending potential liability. The SEC often looks back at once-widespread market practices and decides that, in retrospect, they were problematic. As a result, businesses and investors have been caught up in enforcement "sweeps" for years-old conduct that, to the best of anyone's knowledge, was permissible when engaged in.

Gabelli itself is one example. The petitioners there were among dozens of mutual fund advisers who allegedly permitted market timing, a common practice that had been the subject of public comment and was known to the SEC since the mid-1990s. *See* Mark T. Roche, et al., *Will the SEC Have Forever to Pursue Securities Violations?*: SEC v. Gabelli, 44 SEC. REG. &

L. REP. 1415, at 2 n.3 (July 23, 2012) (citing the government's stipulation in *SEC v. O'Meally*, No. 06-cv-06483 (S.D.N.Y. 2011)). But the SEC reversed course and decided to launch industry-wide enforcement actions after state attorneys general began lawsuits alleging illegal market timing. *See id.* at 2.

Gabelli is far from the only case in which the SEC pursued claims based on conduct that it previously permitted. The SEC recently sought disgorgement from private equity advisers who did not register as investment advisors in the mid-aughts, *In re Blackstreet Capital Mgmt. LLC*, 2016 WL 3072131 (SEC June 1, 2016), even though they were not required to register until 2012, *see* SEC, Rules Implementing Amendment to the Investment Advisers Act of 1940, at 1 (June 22, 2011), 76 Fed. Reg. 42950 (July 19, 2011) (codified at 17 C.F.R. pt. 275, 279). The SEC also recently targeted alternative trading systems that it had accepted as enhancing market liquidity since the 1960s. *See* Luis A. Aguilar, Comm'r, SEC, Public Statement (Nov. 18, 2015), available at https://www.sec.gov/news/statement/shedding-light-on-dark-pools.html (last visited Mar. 2, 2017). There are past examples, too, of the SEC bringing enforcement actions targeting old conduct after changing its position on a widely known and accepted practice. *See, e.g.*, *SEC v. Shanahan*, 646 F.3d 536, 544-45 (8th Cir. 2011) (finding director acted in good faith based on professional advice in back-dating stock options); *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996) (vacating SEC censure, for lack of notice to defendant, where the agency knew about the practice at issue before it occurred and did not condemn it).

The point is not that the SEC may never reconsider market practices to determine if they remain consistent with the securities laws and relevant regulations. But five years provides a more than adequate look-back period if the agency chooses to undertake such a re-examination. The longer the SEC waits to condemn actions considered acceptable at the time, the greater the likelihood that its efforts will disrupt long-settled expectations. The risk of "unfair surprise is acute," this Court has warned, when an agency seeks "to impose potentially massive liability on respondent for conduct that occurred well before" the agency announced its new view, and after "a very lengthy period of conspicuous inaction." *Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2168 (2012). Applying Section 2462 to what the SEC deems to be equitable relief will thus simultaneously limit the agency's ability to unfairly reprimand individuals for conduct that appeared to be permissible at the time, and enhance public confidence in the agency's decision-making by reducing both the perception and the reality of arbitrariness.

Finally, applying Section 2462 to all SEC claims, including for purported equitable relief, will buttress, rather than undermine, core principles of equity by encouraging the SEC to proceed with (relative) dispatch. After all, "'[a] court of equity ... has always refused its aid to stale demands, where the party has slept upon his rights, or acquiesced for a great length of time.'" *Piatt v. Vattier*, 34 U.S. 405, 416 (1835) (citation omitted). Requiring the SEC to institute its enforcement actions promptly is equitable, just, lawful, fair, and right. The agency's contrary position is not.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

THAYA BROOK KNIGHT
ILYA SHAPIRO
CATO INSTITUTE
1000 Mass. Ave., N.W.
Washington, D.C. 20001
tknight@cato.org

MARK A. PERRY
Counsel of Record
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Ave., NW
Washington, D.C. 20036
(202) 955-8500
mperry@gibsondunn.com

GABRIEL K. GILLETT
MARK J. CHERRY
GIBSON, DUNN & CRUTCHER LLP
200 Park Ave.
New York, NY 10166
(212) 351-4000

Counsel for Amicus Curiae

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